



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

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Report Number: A-07-04-03050

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Donald L. Fisher
Vice President
Compensation, Benefits, HRIS, and Risk Management
Highmark, Inc.
1800 Center Street
P.O. Box 890089
Camp Hill, Pennsylvania 17089-0089

Dear Mr. Fisher:

Enclosed are two copies of the Department of Health and Human Services, Office of Inspector General (OIG) report entitled "Pension Segmentation Review at Highmark, Inc. of Pennsylvania" for the period covering December 31, 1997, to January 1, 2002. A copy of this report will be forwarded to the HHS action official noted on the following page for her review and any action deemed necessary.

The action official will make final determination regarding actions taken on all matters in the report. We request that you respond to the action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. § 552, as amended by Public Law 104-231), OIG reports are made available publicly to the extent information contained therein is not subject to exemptions of the Act that the Department chooses to exercise. (See 45 CFR part 5.)

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, ext. 225, or Jenenne Tambke, Audit Manager, at (573) 893-8338, ext. 21, or through email at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-04-03050 in all correspondence.

Sincerely yours,

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures - as stated

Page 2 – Mr. Donald L. Fisher

Direct Reply to HHS Action Official:

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Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**PENSION SEGMENTATION
REVIEW AT HIGHMARK, INC.
OF PENNSYLVANIA**



**JANUARY 2005
A-07-04-03050**

Office of Inspector General

<http://oig.hhs.gov>

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OAS FINDINGS AND OPINIONS

The designation of financial or management practices as questionable or a recommendation for the disallowance of costs incurred or claimed as well as other conclusions and recommendations in this report represent the findings and opinions of the HHS/OIG/OAS. Authorized officials of the awarding agency will make final determination on these matters.



EXECUTIVE SUMMARY

BACKGROUND

Highmark Inc. (Highmark) administers Medicare Part A and B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) after Pennsylvania Blue Shield (PBS) and Veritus, Inc. (Veritus) merged on December 6, 1996.

On December 31, 1997, Highmark merged the Veritus pension plan into the PBS pension plan. Effective January 1, 1998, the PBS plan was amended and restated, and became the pension plan for Highmark.

Starting with fiscal year (FY) 1988, CMS incorporated segmentation requirements into Medicare contracts. The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the segment. Additionally, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with the Cost Accounting Standards (CAS) 412 and 413.

OBJECTIVES

Our objectives were to determine if Highmark:

- identified Medicare pension assets as of December 31, 1997, and
- complied with the pension segmentation requirements of the Medicare contract while updating Medicare segment assets from December 31, 1997, to January 1, 2002.

SUMMARY OF FINDINGS

Highmark did not comply with the pension segmentation requirements of the Medicare contract while updating Medicare segment assets from December 31, 1997, to January 1, 2002. Highmark overstated Medicare Part A segment pension assets by \$2,663,777 and understated Medicare Part B by \$2,394,501. The overstatement and understatement of Medicare pension assets occurred because Highmark did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract and the Medicare segment assets were updated in accordance with CAS 412 and 413.

RECOMMENDATIONS

We recommend that Highmark:

- decrease Medicare Part A segment pension assets by \$2,663,777 and recognize segment assets of \$10,808,230,

- increase Medicare Part B segment pension assets by \$2,394,501 and recognize segment assets of \$41,701,031 as of January 1, 2002, and
- implement controls to ensure that Medicare segments are identified in accordance with the Medicare contract and updated in accordance with CAS 412 and 413.

AUDITEE’S COMMENTS

Highmark’s comments are summarized in the following paragraphs, and its redacted comments are presented in their entirety on Appendix B.

Highmark disagreed with our report and stated that it:

“ . . . does not concur with the OIG’s finding that the Medicare Part A segment assets were overstated by \$2,663,777 and that Medicare Part B segment assets were understated by \$2,394,501, . . . because Highmark did not have adequate controls to ensure that the Medicare segments were identified in accordance with its Medicare contracts and that the Medicare Part A segment and Medicare Part B segment assets were not updated in accordance with CAS 412 and 413.”

Highmark contends that:

- OIG assigned certain participants to incorrect segments,
- most of the audit findings were due to the cumulative effect of the prior audit findings for Medicare Part A and Medicare Part B, and
- most of OIG’s findings concerning the understatement of Medicare Part B segment assets were due to a retroactive application of a recent decision handed down by the U.S. Court of Appeals concerning reassignable pension costs.

OIG RESPONSE

We partially disagree with Highmark’s assertion concerning the overstatement of Medicare Part A segment assets and understatement of the Medicare Part B segment assets.

Our identification of the Medicare segment assets was in accordance with the Medicare contract, and the update of assets was in accordance with CAS 412 and 413. During the course of the audit, we reviewed our identification of the participants and cost centers comprising the Medicare segment with representatives of Highmark and obtained their concurrence. The findings and recommendations of this report are based upon that identification. In its response, Highmark provided revised cost center information for several participants. Although Highmark did not provide us with supporting documentation necessary to accept these revisions, we did compute the impact of such revisions on our report. We determined that including the revised participants did not materially impact the findings of the report, and we will not require Highmark to provide

us with the supporting documentation necessary to accept these revisions. Thus, our position has not changed, and we recommend that Highmark decrease Medicare Part A segment pension assets by \$2,663,777 and increase Medicare Part B segment pension assets by \$2,394,501 as of January 1, 2002.

We do recognize that part of the audit findings are due to the prior audit recommendations for Veritus and PBS; however, those recommendations had not been implemented at the time of our audit of Highmark. Additionally, we acknowledge that a recent decision by the U.S. Court of Appeals affected the method used by Highmark to measure and assign pension costs to periods. The method employed by CMS actuaries reflected this decision and did have a material impact upon the difference between claimed and allowable pension costs used to update the Medicare assets.

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Glossary of Abbreviations and Acronyms

CAS	Cost Accounting Standards
CMS	Centers for Medicare & Medicaid Services
FAR	Federal Acquisition Regulations
OIG	Office of the Inspector General
PBS	Pennsylvania Blue Shield
Veritus	Veritus, Inc.
WAV	Weighted Average Value

INTRODUCTION

BACKGROUND

Medicare

Highmark administered Medicare Part A and B operations under a cost reimbursement contract with CMS after PBS and Veritus merged on December 6, 1996. In claiming costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulations (FAR), the CAS, and the Medicare contract.

On December 31, 1997, Highmark merged the Veritus pension plan into the PBS pension plan. Effective January 1, 1998, the PBS plan was amended and restated, and became the pension plan for Highmark.

CMS incorporated segmentation requirements into Medicare contracts starting in FY 1988. The Medicare contract defines a segment, and specifies the methodology for the identification and initial allocation of pension assets to the segment. Furthermore, the contract requires Medicare segment assets to be updated for each year after the initial allocation in accordance with CAS 412 and 413.

Our previous segmentation review for Part A (A-07-04-00168) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1993, and the update of the segment's assets to December 31, 1997. Our previous segmentation review for Part B (A-07-04-00169) updated the segment assets from January 1, 1992, to December 31, 1997.

Regulations

The CAS 412 regulates the determination and measurement of pension cost components. It also regulates the assignment of pension costs to appropriate accounting periods.

The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs for actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine if Highmark:

- identified Medicare pension assets as of December 31, 1997, and
- complied with the Medicare contract's pension segmentation requirements while updating Medicare segment assets from December 31, 1997, to January 1, 2002.

Scope

We reviewed Highmark's identification of the Medicare segment and its update of Medicare assets from December 31, 1997, to January 1, 2002. Achieving our objectives did not require that we review Highmark's overall internal control structure. However, we did review controls relating to the identification of the Medicare segments and the update of the segment assets to ensure adherence to the Medicare contract, CAS 412, and CAS 413.

We performed onsite audit work at Highmark's office in Camp Hill, PA.

Methodology

In performing this review, we used information provided by Highmark's actuarial consulting firm. The information included assets, liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed Highmark's accounting records, pension plan documents, annual actuarial valuation reports, and Department of Labor/Internal Revenue Service Form 5500s. The CMS pension actuarial staff used the documents to calculate Medicare segment assets as of January 1, 2002. We reviewed the methodology and calculations.

We performed this review in conjunction with our audits of unfunded pension costs (A-07-04-00177) and pension costs claimed for Medicare reimbursement (A-07-04-00163). The information obtained and reviewed during the audits also was used in performing this review.

Details for the updated pension assets of the Medicare segment from December 31, 1997, to January 1, 2002, are presented on Appendix A.

We conducted our review in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

Highmark did not comply with the pension segmentation requirements of the Medicare contract while updating Medicare segment assets from December 31, 1997, to January 1, 2002. As a result, Highmark overstated Medicare Part A segment pension assets by \$2,663,777 and understated Medicare Part B segment pension assets by \$2,394,501 as of January 1, 2002. The overstatement and understatement occurred because Highmark did not have adequate controls to ensure that its Medicare segments were identified in accordance with the Medicare contract and its Medicare segment assets were not updated in accordance with CAS 412 and 413.

ASSETS AS OF DECEMBER 31, 1997

We performed separate pension segmentation audits of the Veritus Part A pension plan (A-07-04-00168) and PBS Part B pension plan (A-07-04-00169) concurrently with the pension segmentation audit of the Highmark pension plan. In the audits, we recommended that Veritus Part A reduce Medicare segment pension assets by \$2,379,567 and PBS Part B increase the

Medicare segment pension assets by \$1,214,985 as of December 31, 1997. We incorporated these recommendations into Highmark's beginning assets values as of December 31, 1997 (see Appendix A).

UPDATE OF MEDICARE SEGMENT ASSETS FROM DECEMBER 31, 1997, TO JANUARY 1, 2002

CRITERIA - MEDICARE CONTRACT & CAS

Medicare Contract

The Medicare contracts identify a Medicare segment as:

“... any organizational component of the contractor, such as a division, department, or other similar subdivision, having a significant degree of responsibility and accountability for the Medicare contract/agreement, in which:

1. The majority of the salary dollars is allocated to the Medicare agreement/contract; or,
2. Less than a majority of the salary dollars is allocated to the Medicare agreement/contract, and these salary dollars represent 40 percent or more of the total salary dollars allocated to the Medicare agreement/contract.”

Furthermore, the Medicare contract states “... the pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7).”

CAS

CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, permitted unfunded accrual, income, benefit payments, and expenses. In addition, CAS 413.50(c)(8) requires an adjustment to be made for transfers (participants who enter or leave the segment) if the transfers materially affect the segment's ratio of pension plan assets to actuarial accrued liabilities.

According to CAS 412.50(a)(4), prepayment credits are funds available to the contractors at the beginning of plan years. Funds should be applied first to satisfy funding requirements in order to reduce interest costs to the Government.

CONDITION - COMPONENTS OF ASSET UPDATE

Contributions Overstated

Highmark's update methodology did not equitably assign pension contributions to the Medicare segment, because it did not correctly identify the Medicare segment in accordance with the Medicare contract. As a result, Highmark overstated segment assets by \$1,743,449.

The audited update of Medicare segment assets assigned contributions to the Medicare segment using the pension costs as calculated by the CMS Office of the Actuary. The Medicare segment assets decreased by \$1,743,449 in the audited update due to differences in assigned contributions. A comparison of Highmark and OIG's calculations of pension contributions follows:

Contributions			
Part B			
Year	OIG	Highmark	Difference
1998	\$194,791	\$1,938,240	\$1,743,449
Total	\$194,791	\$1,938,240	\$1,743,449

Prepayment Credits Understated

Highmark incorrectly identified prepayment credits allocable to the Medicare segment and therefore understated the Medicare segment prepayment credits by \$2,322,403 (Medicare Part A by \$527,232 and Medicare Part B by \$1,795,171). For the year 2001 for Medicare Part A and years 1998 and 1999 for Medicare Part B, Highmark's assigned contributions exceeded the required funding of the CAS pension cost. According to CAS 412-50(c)(1), amounts funded in excess of pension costs (or prepayment) shall be carried forward with interest to fund future CAS pension costs. We considered these excess contributions in our computations and allocated prepayment credits as needed to the Medicare segment to fund CAS pension costs.

Prepayment Credits						
Part A				Part B		
Year	OIG	Highmark	Difference	OIG	Highmark	Difference
1998	\$0	\$0	\$0	\$1,738,743	\$0	(\$1,738,743)
1999	0	0	0	1,838,303	1,781,875	(56,428)
2000	0	0	0	0	0	0
2001	527,232	0	(527,232)	0	0	0
	<u>\$527,232</u>	<u>\$0</u>	<u>(\$527,232)</u>	<u>\$3,577,046</u>	<u>\$1,781,875</u>	<u>(\$1,795,171)</u>

Benefit Payments Overstated

Due to the incorrect identification of the Medicare segment participants, Highmark's update of segment assets did not properly identify benefit payments to retirees from the Medicare segment. We identified the actual benefits paid to the retirees from the Medicare segment and assigned these costs to the Medicare segment. This resulted in an overstatement of Medicare segment benefit payments by \$472,917 (Medicare Part A by \$446,225 and Medicare Part B by \$26,692).

Transfers Understated

Highmark made adjustments for transfers (the movement of participants in and out of the segment each year) in its update of segment assets from December 31, 1997, to January 1, 2002.

However, Highmark incorrectly identified the participants who transferred in and out of the segment, which resulted in an understatement of Medicare segment assets of \$157,783 (Medicare Part A overstated by \$255,628 and Medicare Part B understated by \$413,411). Transfers for the audited update were adjusted based on our revisions to the Medicare segment.

A comparison of OIG and Highmark's calculations of net asset transfers into and from the Medicare segments are shown in the schedule below.

Transfers						
Year	Part A			Part B		
	OIG	Highmark	Difference	OIG	Highmark	Difference
1997	\$225,247	\$63,200	\$162,047	(\$31,077)	(\$402,873)	\$371,796
1998	11,090	171,714	(160,624)	(242,627)	(288,866)	46,239
1999	31,196	29,232	1,964	(463,356)	(348,249)	(115,107)
2000	82,779	77,044	5,735	(140,302)	(204,851)	64,549
2001	(241,250)	23,500	(264,750)	(136,102)	(182,036)	45,934
	<u>\$109,062</u>	<u>\$364,690</u>	<u>(\$255,628)</u>	<u>(\$1,013,464)</u>	<u>(\$1,426,875)</u>	<u>\$413,411</u>

Earnings and Expenses Understated

Highmark understated allocable investment earnings, less administrative expenses, by \$631,486 (Medicare Part A overstated by \$109,589 and Part B understated by \$741,075). The understatement occurred because the Medicare asset base was developed using incorrect contribution, prepayment credit, transfer, and benefit amounts (discussed above).

It was Highmark's practice to allocate investment income to the Medicare segment based on the time-weighted value of assets. Additionally, administrative expenses to the segment were allocated in proportion to the allocation of earnings. However, for plan years beginning after March 30, 1995, the CAS requires investment income and expenses to be allocated among segments based on the ratio of the segment's weighted average value (WAV) of assets to total company WAV of assets. The audited update of Medicare segment assets reflects the required change in methodology.

CAUSE - LACK OF ADEQUATE CONTROLS

Highmark did not have adequate controls to ensure that the Medicare segment was identified in accordance with the Medicare contract and that Medicare segment pension assets were updated in accordance with CAS 412 and 413.

EFFECT - OVERSTATEMENT OF MEDICARE SEGMENT ASSETS

As of January 1, 2002, Highmark overstated Medicare Part A segment pension assets by \$2,663,777, and understated Medicare Part B by \$2,394,501.

RECOMMENDATIONS

We recommend that Highmark:

- decrease the Medicare Part A segment pension assets by \$2,663,777,
- increase the Medicare Part B segment pension assets by \$2,394,501 as of January 1, 2002, and
- ((bullet size off))implement controls to ensure that the Medicare segments are identified in accordance with the Medicare contract and updated in accordance with CAS 412 and 413.

AUDITEE'S COMMENTS

Highmark's comments are summarized in the following paragraphs, and its redacted comments are presented in their entirety on Appendix B.

Highmark disagreed with our report and stated that it:

“... does not concur with the OIG's finding that the Medicare Part A segment assets were overstated by \$2,663,777 and that Medicare Part B segment assets were understated by \$2,394,501, ... because Highmark did not have adequate controls to ensure that the Medicare segments were identified in accordance with its Medicare contracts and that the Medicare Part A segment and Medicare Part B segment assets were not updated in accordance with CAS 412 and 413.”

Highmark contends that:

- OIG assigned certain participants to incorrect segments,
- most of the audit findings were due to the cumulative effect of the prior audit findings for Medicare Part A and Medicare Part B, and
- most of OIG's findings concerning the understatement of Medicare Part B segment assets were due to a retroactive application of a recent decision handed down by the U.S. Court of Appeals concerning reassignable pension costs.

OIG RESPONSE

We partially disagree with Highmark's assertion concerning the overstatement of Medicare Part A segment assets and understatement of the Medicare Part B segment assets.

Our identification of the Medicare segment assets was in accordance with the Medicare contract, and the update of assets was in accordance with CAS 412 and 413. During the course of the audit, we reviewed our identification of the participants and cost centers comprising the Medicare segment with representatives of Highmark and obtained their concurrence. The findings and recommendations of this report are based upon that identification. In its response, Highmark provided revised cost center information for several participants. Although Highmark did not provide us with supporting documentation necessary to accept these revisions, we did compute the impact of such revisions on our report. We determined that including the revised participants did not materially impact the findings of the report (less than .5% change), and we will not require Highmark to provide us with the supporting documentation necessary to accept these revisions. Thus, our position has not changed, and we recommend that Highmark decrease Medicare Part A segment pension assets by \$2,663,777 and increase Medicare Part B segment pension assets by \$2,394,501 as of January 1, 2002.

We do recognize that part of the audit findings are due to the prior audit recommendations for Veritus and PBS, however those recommendations were not implemented at the time of our audit of Highmark. Additionally, we acknowledge that a recent decision by the U.S. Court of Appeals affected the method used by Highmark to measure and assign pension costs to periods. The method employed by CMS actuaries reflected this decision and did have a material impact upon the difference between claimed and allowable pension costs used to update the Medicare assets.

APPENDIXES

Highmark Inc
Statement of Medicare Pension Assets
For the Period December 31, 1997, to January 1, 2002

Description		Total Company	Other Segment	Medicare Part A	Medicare Part B
Assets December 31, 1997	<u>1/</u>	383,073,606	335,813,578	9,821,687	37,438,341
Transfers	<u>2/</u>	0	(194,170)	225,247	(31,077)
Assets January 1, 1998		383,073,606	335,619,408	10,046,934	37,407,264
Prepayment Transfer	<u>3/</u>	0	(1,738,743)	0	1,738,743
Contributions	<u>4/</u>	9,933,000	9,760,018	0	172,982
Transfer to IBC	<u>5/</u>	(5,317,165)	(5,317,165)	0	0
Earnings	<u>6/</u>	65,134,060	56,860,247	1,695,590	6,578,223
Benefit Payments	<u>7/</u>	(15,728,821)	(13,244,648)	(417,817)	(2,066,356)
Expenses	<u>8/</u>	(1,727,632)	(1,508,176)	(44,974)	(174,482)
Transfers		0	231,537	11,090	(242,627)
Assets January 1, 1999		435,367,048	380,662,478	11,290,823	43,413,747
Prepayment Transfer		0	(1,794,365)	0	1,794,365
Contribution		0	0	0	0
Transfer to UPMC Plan	<u>9/</u>	(413,774)	(413,774)	0	0
Earnings		41,406,338	36,056,079	1,075,660	4,274,599
Benefit Payments		(17,410,585)	(14,649,911)	(418,661)	(2,342,013)
Expenses		(1,809,837)	(1,575,982)	(47,016)	(186,839)
Transfers		0	432,160	31,196	(463,356)
Assets January 1, 2000		457,139,190	398,716,685	11,932,002	46,490,503
Asset Value Adjustment					
Prepayment Transfer		0	0	0	0
Contribution		0	0	0	0
Transfer to IBC Plan	<u>5/</u>	(93,383)	(93,383)		
Earnings		10,358,275	9,039,396	269,996	1,048,883
Benefit Payments		(15,404,243)	(12,997,454)	(436,641)	(1,970,148)
Expenses		(1,896,234)	(1,654,794)	(49,427)	(192,013)
Transfers		0	57,523	82,779	(140,302)
Assets January 1, 2001		450,103,605	393,067,973	11,798,709	45,236,923

Highmark Inc
Statement of Medicare Pension Assets
For the Period December 31, 1997, to January 1, 2002

Description	Total Company	Other Segment	Medicare Part A	Medicare Part B
Assets January 1, 2001	\$450,103,605	\$393,067,973	\$11,798,709	\$45,236,923
Prepayment Transfer	0	(93,994)	93,994	0
Contribution	0	0	0	0
Earnings	(11,682,672)	(10,205,079)	(308,129)	(1,169,464)
Benefit Payments	(16,313,035)	(13,846,368)	(472,794)	(1,993,873)
Expenses	(2,362,110)	(2,063,357)	(62,300)	(236,453)
Transfers	0	377,352	(241,250)	(136,102)
Assets January 1, 2002	419,745,788	367,236,527	10,808,230	41,701,031
Per Highmark	<u>10/</u>	\$419,745,788	\$366,967,251	\$13,472,007
Asset Variance	<u>11/</u>	\$0	(\$269,276)	\$2,663,777
				(\$2,394,501)

Highmark Inc
Statement of Medicare Pension Assets
For the Period December 31, 1997, to January 1, 2002

FOOTNOTES

- 1/ We determined the Medicare segment assets as of December 31, 1997, in our prior review of Medicare Part A Veritus's pension segmentation (report number: A-07-04-00168) and Medicare Part B PBS' pension segmentation (report number: A-07-04-00169). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.
- 2/ We identified participant transfers between segments by comparing valuation data files provided by Highmark. Our transfer adjustment considered each participant's actuarial liability and the funding level of the segment from which the participant transferred. The asset transfers were equal to the actuarial liability determined under the accrued benefit cost method in accordance with the CAS.
- 3/ Prepayment credits represent funds available to satisfy future funding requirements and are applied to future funding requirements before current year contributions in order to reduce interest costs to the Government. Prepayment credits are transferred to the Medicare segment as needed to cover funding requirements.
- 4/ We obtained total company contribution amounts from the actuarial valuation reports. We allocated total company contributions to the Medicare segment based on the ratio of the Medicare segment funding target divided by the total company funding target. Contributions in excess of the funding targets were treated as prepayments credits and accounted for in the "Other" segment until needed to fund pension cost in future.
- 5/ Net assets transferred out to the IBC Pension Plan represent a transaction involving business units outside the Medicare segment and therefore does not affect the Medicare segment.
- 6/ We obtained investment earnings from actuarial valuation reports. Highmark allocated its investment earnings based on a ratio of the time weighted value of assets for all years. We allocated investment earning using Highmark's methodology.
- 7/ We based the Medicare segment's benefit payments on actual payments to Medicare retirees. Highmark provided us with supporting documentation for benefit payment amounts to plan retirees. We used actual benefit payments for Medicare segment retirees.
- 8/ We allocated administrative expenses to the Medicare segment in proportion to investment income. Highmark used the same methodology.
- 9/ Net assets transferred out to the UPMC Pension Plan represent a transaction involving business units outside the Medicare segment and therefore does not affect the Medicare segment.

Highmark Inc
Statement of Medicare Pension Assets
For the Period December 31, 1997, to January 1, 2002

- 10/ We obtained total asset amounts as of January 1, 2002, from Highmark's actuarial valuation report prior to transfer adjustments.
- 11/ The asset variance represents the difference between the OIG calculation of Medicare segment assets and Highmark's market value of assets shown in its valuation report.



January 6, 2005

Mr. James P. Aasmundstad
Regional Inspector General for Audit Services
DHHS, OIG
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

**RE: A-07-04-03050 ("Pension Segmentation Review at Highmark, Inc. of Pennsylvania")
 A-07-04-00163 ("Review of Pension Costs Claimed for Medicare Reimbursement
 by Highmark Inc. for Fiscal Years 1998 through 2002")
 A-07-04-00177 ("Audit of Highmark's Unfunded Pension Costs for the period
 covering 1997 Through 2001")**

Dear Mr. Aasmundstad:

Attached is our response to your letters dated November 4, 2004, requesting comments on your draft reports A-07-04-03050 entitled, "Pension Segmentation Review at Highmark, Inc. of Pennsylvania" for the period covering December 31, 1997 to January 1, 2002; A-07-04-00163 entitled, "Review of Pension Costs Claimed for Medicare Reimbursement by Highmark, Inc. for Fiscal Years 1998 through 2002;" and A-07-04-00177 entitled, "Audit of Highmark's Unfunded Pension Costs for the period covering 1997 through 2001."

If you have any questions, please feel free to contact me at 717-302-4175.

Sincerely,

A handwritten signature in cursive script that reads "Donald L. Fisher".

Donald L. Fisher, Vice President
Compensation, Benefits, HRIS &
Risk Management

cc: James Chiado
Elizabeth Farbacher
Patrick Kiley
Anthony Lobato
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Pension Segmentation Review
At Highmark, Inc.
Of Pennsylvania

December 31, 1997 to January 1, 2002

Highmark Comments to OIG Draft Report
A-07-04-03050

Highmark's Comments on Report Number A-07-04-03050

Highmark does not concur with the OIG's finding that the Medicare Part A segment assets were overstated by \$2,663,777 and that Medicare Part B segment assets were understated by \$2,394,501, nor does Highmark concur with the conclusion that the misstatement of assets occurred because Highmark did not have adequate controls to ensure that the Medicare segments were identified in accordance with its Medicare contracts and that the Medicare Part A segment and Medicare Part B segment assets were not updated in accordance with CAS 412 and 413. Highmark disagrees with the OIG's segment assignment of certain participants identified in the attached Exhibits I, II, III and IV, and also believes that some of the Part A overstatement and most of the Part B understatement of segment assets was the result of the OIG's retroactive application of a recent decision of the United States Court of Appeals for the Federal Circuit (*Eastman Kodak Company v. Donald H. Rumsfeld, Secretary of Defense*). It is also our understanding that both of the above transfer amounts not only represent the amounts for the current audit period (December 31, 1997 to January 1, 2002), but also are cumulative amounts for the entire period (January 1, 1993 to January 1, 2002, for Part A, and January 1, 1992 to January 1, 2002, for Part B). For the reasons described below, Highmark respectfully requests that revisions to the OIG report be made.

As a result of the cumulative nature of the findings on assets described above, Highmark believes that the current audit report is misleading with regard to the severity of the financial effects of the problems uncovered during the current audit period. The Part A audit recommends an asset decrease of \$2.7 million as of January 1, 2002. We estimate that over 90% of this amount is the result of the issues uncovered in the audit for the period ending in 1997. Similarly, the Part B audit recommends an asset increase of \$2.4 million as of January 1, 2002. We estimate that about two-thirds of this amount is due to the issues uncovered in the audit for the period ending in 1997.

Highmark agrees that several cost centers were incorrectly assigned to segments, but believes it was due to human error rather than an inherent lack of adequate controls. Some of the errors occurred as Highmark merged two distinct corporate pension plans (i.e., the Veritus Inc. pension plan with the Pennsylvania Blue Shield pension plan), and moved to a single Highmark

Inc. human resource and financial system in 1998, following the statutory consolidation that created Highmark Inc.

As noted in the attachments, the cost center numbers shown for some participants in the listings provided to the OIG were in error; consequently, the segment assignment by the OIG is incorrect for those participants. The error occurred when participant listings with cost centers were recreated from several source documents for the audit. In some cases, a participant terminated and was subsequently rehired, but the listing included the original termination cost center rather than the employee's last active cost center. In other cases, the first digit of some Veritus Inc. cost center numbers were inadvertently omitted. When cost centers were transferred from Veritus Inc. to Highmark's system, they only had three digits and some were duplicates of Pennsylvania Blue Shield (PBS) cost center numbers. In early 1998, a fourth digit was added to the beginning of all Veritus Inc. cost center numbers to avoid duplicate numbers and provide clear distinction between a former Veritus Inc. versus PBS cost center number. Highmark's pension actuary doesn't use or maintain cost center numbers, but rather utilizes a segment indicator to assign participants to a segment. Although these old Veritus Inc. cost center numbers created some confusion during the audit, Highmark's pension actuary for the most part assigned participants correctly even though a document provided to the auditors may have contained some old Veritus Inc. cost center numbers. In addition, since the segment indicator doesn't change upon an employee's termination, it is not necessary to continue to identify the segment assignment for cost centers for retirees and terminated-vested participants who terminated in prior years – only the segment indicator.

In addition to the above issues, there are other participant assignments made by the OIG that Highmark believes are incorrect, as noted in Exhibits I, II, III and IV.

Accordingly, Highmark requests that the OIG's audit report should separately identify: 1) the amount of the finding attributable to the retroactive application of the recent Kodak "full funding limit" decision that was not a part of the measurement and assignment practices that were previously followed by either the OIG, the Highmark's predecessor corporations, or Highmark's pension actuary; 2) the amounts attributable to the issues uncovered in the Part A and Part B audits for the period ending in 1997; and, 3) the amounts of the finding due to the incorrect assignment of cost centers and participants to the Medicare Part A and Part B segments, after revising their calculations for the participants identified in Exhibits I, II, III and IV.

Participants not included in the Medicare B Segment by OIG that Should Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Medicare B	399	Special Correspondence (In 1988 it was titled Provider Telephone & General Inquiry Services)	1998 1999 2000 2001 2002	This participant retired in 1988 from Cost Center 399 and began collecting her retirement benefit. Cost Center 399 was a Medicare Part B cost center at that time. She later worked part-time in Cost Center 398, which is also a Medicare B cost center according to information provided to OIG by Highmark. She did not accrue any additional service after commencing retirement benefit payments.
	Medicare B	020	Medicare Incoming Mail	1998 1999	This Cost Center was in Medicare Part B when the employee terminated in 1979 with a vested benefit. The cost center is listed as Medicare B on the information provided to OIG by Highmark.
	Medicare B	20	Medicare Incoming Mail	1998 1999 2000 2001 2002	This Cost Center was in Medicare Part B when the employee terminated in 1986 with a vested benefit. The cost center is listed as Medicare B on the information provided to OIG by Highmark.
	Medicare B	185	Medicare Medical Review - Sect. A	1999 2000 2001 2002	This Cost Center was in Medicare Part B when the employee terminated in 1988 with a vested benefit. The cost center is listed as Medicare B on the information provided to OIG by Highmark.
	Medicare B	185	XACT Medicare Medical Review	2000 2001 2002	This Cost Center was in Medicare Part B when the employee terminated in 1999 with a vested benefit. The cost center is listed as Medicare B on the information provided to OIG by Highmark.
	Medicare B	431	XACT Medicare Telephone Services	2000 2001 2002	This employee terminated with a vested benefit from Cost Center 431 in 1999. Prior to termination she had been on leave of absence for an extended period of time. At the time of her termination Cost Center 431 was in the Medicare B segment. The cost center is listed as a Medicare B cost center on the list provided to the auditors.
	Medicare B	105	XACT Medicare EMC Edit/Suspensions	2000 2001 2002	This employee terminated with a vested benefit from Cost Center 105 in 1999. Prior to termination she had been on leave of absence for an extended period of time. At the time of her termination Cost Center 105 was in the Medicare B segment. The cost center is listed as a Medicare B cost center on the list provided to the auditors.

Participants **not** included in the Medicare B Segment by OIG that **Should Be**

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Medicare B	105	XACT Medicare EMC Edi/Suspensions	2000 2001 2002	This employee terminated with a vested benefit from Cost Center 105 in 1999. Prior to termination she had been on leave of absence for an extended period of time. At the time of her termination Cost Center 105 was in the Medicare B segment. The cost center is listed as a Medicare B cost center on the list provided to the auditors.
	Medicare B	474	XACT Medicare Core Svc. Post Payment Processing	2000 2001	This employee terminated with a vested benefit from Cost Center 474 in 1999. Prior to termination she had been on leave of absence for an extended period of time. At the time of her termination Cost Center 474 was in the Medicare B segment. The cost center is listed as a Medicare B cost center on the list provided to the auditors.
	Medicare B	171	Xact Medicare Inquiry Control	2001 2002	This employee terminated with a vested benefit from Cost Center 171 in 1999. Her Social Security number differs by one digit from the actuary's record for that year. Cost Center 171 was a Medicare B cost center in 1999 and is listed as a Medicare B cost center on the information provided to the auditors.
	Medicare B	185	Medicare Claims Review	2001 2002	This employee terminated with a vested benefit from Cost Center 185 in 1983. Cost Center 185 was a Medicare B cost center in 1983.
	Medicare B	399	Provider Telephone & General Inquiry Services	2002	This employee terminated in 1990 with a vested benefit from Cost Center 399. This cost center was in the Medicare B segment in 1990.

Participants included in the Medicare B Segment by OIG that Should Not Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Indirect	189	PA/DEL Champus	1998 1999 2000 2001 2002	This participant terminated with a vested benefit in 1980 from Cost Center 189. Based on the cost center review dated November 1980, cost center 189 was called PA/DEL Champus. Based on the name and the fact the CC was in the Corporate area (not in the GBU), cost center 189 should NOT have been in the Medicare segment. CC 189 was not on the Medicare B list provided to the auditors.
	Indirect	5	Sr, VP Mid-Atlantic Region	1998 1999 2000 2001 2002	This participant terminated with a vested benefit from Cost Center 05 in 1997. Cost center 005 was not in the Medicare segment in 1997 when this participant terminated. The last year it was included in the Medicare B segment was 1996.
	Indirect	77	Employee Relations	1998 1999 2000 2001 2002	This participant retired from Cost Center 077 in 1984. Cost center 077 was not included on the list of Medicare B cost centers provided to the auditors. It was not in the Medicare segment in 1984 when this person terminated.
	Medicare A	4372	Medicare A - Provider Field Audit, West	1998 1999 2000 2001 2002	The participant information provided to OIG was in error. This participant terminated from Cost Center 4372 with a vested benefit in 1998. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4372, was determined to have been in the Medicare A segment when this employee terminated employment.
	Indirect	4441	Provider Data Services	1998 1999 2000 2001 2002	The participant information provided to OIG was in error. This participant terminated from Cost Center 4441 with a vested benefit in 1998. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4441, was determined NOT to have been in the Medicare B segment when this employee terminated employment.

Participants included in the Medicare B Segment by OIG that Should Not Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Indirect	4426	Director, Training & Development	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4426 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4426, was determined NOT to have been in the Medicare B segment in 1998.
	Indirect	4685	Executive Inquiry & Grievance Admin.	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4685 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4685, was determined NOT to have been in the Medicare B segment in 1998.
	Indirect	4196	Government & Public Affairs	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4196 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4196, was determined NOT to have been in the Medicare B segment in 1998.
	Indirect	158	VP, Govt. Affairs	1999 2000 2001 2002	This participant terminated from Cost Center 158 in 1998 with a vested benefit. Cost Center 158 was determined NOT to have been in the Medicare segment when this person terminated
	Indirect	4473	AVI, Subsidiary Accounting	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4473 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4473, was determined NOT to have been in the Medicare B segment in 1998.
	Medicare A	4372	Medicare A - Provider Field Audit	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4372 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This Cost Center 4372, was determined to have been in the Medicare A segment in 1998.

Participants included in the Medicare B Segment by OIG that Should Not Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Indirect	4426	Director, Training & Development	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4426 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning. This Cost Center 4426, was determined NOT to have been in the Medicare B segment in 1998.
	Indirect	4426	Director, Training & Development	1998	The participant information provided to OIG was in error. This participant was active in Cost Center 4426 on 1/1/98. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning. This Cost Center 4426, was determined NOT to have been in the Medicare B segment in 1998.
	Indirect	140	OSCAR Analysis	1999	Participant information provided to auditors indicates this employee was in cost center 166. She was in that cost center up through 1993. However, on 1/1/99, she was in cost center 140. Cost center 140 was not a Part B cost center in 1999. The cost center information provided was from a prior record, before a transfer of the employee.
	Indirect	763	KHPC Int/Prog Ded Unit	1999	Participant information provided to auditors indicates this employee was in cost center 680. She was in that cost center up through 1994. However, on 1/1/99, she was in cost center 763. Cost center 763 was not a Medicare Part B cost center in 1999. The cost center information provided was from a prior record, before a transfer of the employee from one company to another. She terminated from 763 in 2001.
	Indirect	2193	TFMDP Customer Service	1999	Participant information provided to auditors indicates this employee was in cost center 274. She was in that cost center into 1996. However, on 1/1/99, she was in cost center 2193. Cost center 2193 was not a Medicare Part B cost center in 1999. The cost center information provided was from a prior record before a transfer of the employee from one company to another. She terminated from 274 in 2002.

Participants included in the Medicare B Segment by OIG that Should Not Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
<i>"Data Redacted by OAS Auditors"</i>	Indirect	84	Director, Compensation & Benefits	1999	Participant information provided to auditors indicates this employee was in cost center 106. She was in that cost center until 1989, when she terminated. She was later re-hired. On 1/1/99, she was in cost center 084. Cost center 084 was not a Medicare Part B cost center in 1999. The cost center information provided was from a prior record before the termination and rehire of the employee.

Participants **not** included in the Medicare A Segment by OIG that **Should Be**

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
<i>"Data Redacted by OAS Auditors"</i>	Medicare A	4372	Medicare A - Provider Field Audit, West	1998 1999 2000 2001 2002	Research indicates this employee terminated with a vested benefit in 1996 from Cost Center 4372, which was determined to be in the Medicare A segment.
	Medicare A	4372	Medicare A - Provider Field Audit, West	1998 1999 2000 2001 2002	The participant information provided to OIG was in error. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning. This participant was in Cost Center 4372 all of 1998. This cost center was determined to have been in the Medicare A segment in 1998 when this employee terminated employment with a vested benefit.
	Medicare A	4372	Medicare A - Provider Field Audit, West	1998	Participant information provided to OIG was in error. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning. This participant was active in Cost Center 4372 on 1/1/98. This cost center was determined to have been in the Medicare A segment in 1998. This employee was not vested when he terminated employment in 1998.
	Medicare A	4546	Medicare A - Determination II	1998 1999 2000 2001 2002	Participant information provided to OIG was in error. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This employee terminated with a vested benefit from Cost Center 4546 in 1997. This cost center was determined to have been in the Medicare A segment when this employee terminated employment.
	Medicare A	4443	Medicare A - Medical Review	1998 1999	Participant information provided to OIG was in error. The first digit of this cost center was missing. When cost centers were transferred from Veritus to Highmark's system, they only had three digits. In early 1998 a fourth digit was added to the beginning of the three digit cost center number. This employee was active in Cost Center 4443 on 1/1/98. This cost center was determined to have been in the Medicare A segment on 1/1/98. It is included on the listing provided to the auditors.

Participants not included in the Medicare A Segment by OIG that Should Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
"Data Redacted by OAS Auditors"	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.
	Medicare A	1322	Medicare A - Chief Financial Officer & Contract Management	2002	This employee was active employee in Cost Center 1322 on 1/1/02. This cost center first became part of the Medicare A segment in 2001. It is on the list that was provided to the auditors as a Medicare A cost center.

Participants included in the Medicare A Segment by OIG that Should Not Be

Participant	Segment	Cost Center		Valuation Impacted	Explanation
		Number	Name		
<i>"Data Redacted by OAS Auditors"</i>	Indirect	366	Inter-plan Processsing	1998 1999 2000 2001 2002	This employee was in PBS Cost Center 366 as of 1/1/98 and terminated with a vested benefit in 1998. Cost center 366 was on the list as a Veritus Part A Medicare cost center in 1997. In 1998 it became cost center 4366. This employee was in 366, a PBS indirect segment cost center. Auditors probably thought this was the Veritus Part A cost center - 366 that was on the list in 1997.
	Indirect	363	Staff Support - Special Programs	1998	This employee was in PBS Cost Center 363 as of 1/1/98 and terminated with a vested benefit in 1998. Cost center 363 was on the list as a Veritus Part A Medicare cost center in 1997. In 1998 it was no longer on that list. This employee was in 363, a PBS indirect segment cost center. Auditors probably thought this was the Veritus Part A cost center - 363 that was on the list in 1997.
	Indirect	363	Staff Support - Special Programs	1998	This employee was active in PBS Cost Center 363 as of 1/1/98. Cost center 363 was on the list as a Veritus Part A Medicare cost center in 1997. In 1998 it is no longer on that list. This employee was in 363, a PBS indirect segment cost center. Auditors probably thought this was the Veritus Part A cost center - 363 - that was on the list in 1997. (Termed with a vested benefit from 363 in 2000.)
	Indirect	363	Staff Support - Special Programs	1998	This employee was in PBS Cost Center 363 as of 1/1/98 and upon termination in 1998. Cost center 363 was on the list of Veritus Part A Medicare cost centers in 1997. In 1998 it is not on the list. This employee was in 363, a PBS indirect segment cost center. Auditors probably thought this was the Veritus Medicare A cost center - 363-that was on the list in 1997.